ELEPHANTS IN THE ROOM: SUPREME COURT AND JUDICIAL REFORMS - PROMOTING INVESTMENTS IN INDIA

- Navneet Nair and Shubhi Pahwa*

ABSTRACT

India is the fifth largest economy in the world. While India holds the title for the fastest growing trillion-dollar economy in the world, it is also notorious for its turtle paced dispute resolution mechanism. As of May 2020, over 3.24 crore cases are pending across various district and *taluka* courts in India, out of which over 2.45 crore cases (~75.86%) are more than one year old.[1] Over 48 lakh cases are pending across various High Courts of which over 31 lakh cases are more than one year old.[2] Another 60 thousand cases are pending before the Hon'ble Supreme Court of India.[3] It is not long back that an International Chamber of Commerce arbitral tribunal had pulled up India and directed it to pay AUS$ 4.85 million to a corporation for being in violation of its treaty obligations under the India-Australia BIT (Bilateral Investment Treaty).[4] The Tribunal had held that India failed to provide investors with effective means to enforce their rights in light of the fact that India's Supreme Court had been unable to dispose of an appeal filed by an Australian investor for a period of more than five years. While the pendency may be attributed to multiple factors, reforms initiated in the last

* Navneet Nair is an Advocate practising in the Supreme Court of India and the High Court of Delhi. Shubhi Pahwa is an Associate at Khaitan & Co. The views expressed in the article are authors' own and do not represent the views of any organisation.

[1] Information as available at National Judicial Data Grid (District and Taluka Courts of India) on 15.05.2020, available at: https://njdg.ecourts.gov.in/njdgnew/index.php

[2] Information as available at National Judicial Data Grid (High Courts) on 15.05.2020, available at: https://njdg.ecourts.gov.in/hcnjdg_public/main.php. It is to be noted that this information does not include High Court of Bombay, Delhi, and Madhya Pradesh.

[3] Information as available on the basis of Statistics issued by the Supreme Court of India, available at: https://main.sci.gov.in/statistics as of 01.03.2020.

[4] White Industries Australia Limited v. Republic of India, Final Award delivered on 30.11.2011. (J. William Rowley, Charles N. Brower, & Christopher Lau), https://www.italaw.com/sites/default/files/case-documents/ita0906.pdf.

decade have been promising as far as India's movement towards establishing a faster and more efficient judicial system is concerned.

I. INTERPLAY OF LAW AND ECONOMY

A smooth and efficient legal system is important for any economy in as much as it is able to catalyse the economic growth through increased investments. For increasing investments, the regulatory, tax and legal environment needs to play an enabling role. Investment involves a certain degree of risk and innovation. It is futile to expect risk and innovation from investors if there exists an uncertain legal regime. Importance of a stable and consistent legal regime has been discussed over generations, with thinkers like Chanakya suggesting that rule of law is rudimentary to avert law of the jungle.[5] In order to increase productivity of businesses, judicial efficiency is essential. There are various studies, in the context of India, which have established a direct relationship between the speed of contract enforcement and liberalization of tariffs. Further studies have also indicated that in countries which have an efficient judicial system, gains in productivity from a reduction in input tariffs are highest.[6] Financial markets improve as and when a judicial system improves. The efficiency of a judicial system is also a significant determinant of higher performance for domestic sales as well as exports.[7]

[5] KAUṬALYA, THE ARTHASHASTRA (L. N. Rangarajan 2d ed., Penguin Books India 2012).
[6] Reshad Ahsan, *Input Tariffs, Speed of Contract Enforcement, and the Productivity of Firms in India*, 90(1) JOURNAL OF INTERNATIONAL ECONOMICS 181–92 (2013).
[7] Pavel Chakraborty, *Judicial Quality and Regional Firm Performance: The Case of Indian States*, 44 (4) JOURNAL OF COMPARATIVE ECONOMICS 902–18 (2016).

A. Reforms in India

India has witnessed remarkable legal reforms in the last five years, and has been amongst the top ten improvers for the third year in a row in the World Bank's Ease of Doing Business Report, where India's ranking has improved from being ranked at 142nd place to being ranked at the 63rd position, all in a span of five years.[8] Apart from India, only the Arab Republic of Egypt, Burundi, Colombia and Georgia have been in the list of ten top improvers for three consecutive times.[9] Despite the monstrous pendency, Indian judicial system is one of the most refined legal systems in the world. The Hon'ble Supreme Court of India has been at the forefront of bringing about a change in the Indian society with its ingenuity of thought. Even though judicial vacancies are on the rise, and the infrastructural support being provided to judges in lower courts is abysmal, Courts have, of late, been working against all odds to favour investor sentiment and providing a consistent legal regime.

B. Relevant decisions of the Supreme Court

1. SCG Contracts India Pvt. Ltd. v. K.S. Chamankar Infrastructure Pvt. Ltd.

In the last one year, Supreme Court has rendered a number of judgments that foster an investor friendly judicial climate. In *SCG*

[8] World Bank. 2020, *Doing Business 2020: Comparing Business Regulation in 190 Economies. Washington, DC: World Bank*, © WORLD BANK (2020), https://openknowledge.worldbank.org/handle/10986/32436 License: CC BY 3.0 IGO.
[9] *Id.*

Contracts India Pvt. Ltd. v. K.S. Chamankar Infrastructure Pvt. Ltd.,[10] the Supreme Court, in order to preserve the objective of the Commercial Courts Act, 2015, held that in commercial suits, written statement of the defendant has to be mandatorily filed within 120 days of the service of summons, and therefore, it cannot be taken on record after the expiry of the said 120 days. This will have a positive spill over effect on the time being taken for the completion of judicial proceedings under the Commercial Courts Act. A recent constitution bench judgment in *New India Assurance Company Ltd. v. Hilli Multipurpose Cold Storage Private Limited*, C.A. Nos. 19041-42/2013, has on similar lines decided in respect of consumer disputes that time for filing a reply cannot be extended beyond a period of 45 days as prescribed under the Consumer Protection Act.

2. Simplex Infrastructure Ltd. v. Union of India

In *Simplex Infrastructure Ltd. v. Union of India*,[11] the Supreme Court held that an application for setting aside an arbitral award on any of the grounds provided in Section 34(2) of the Arbitration and Conciliation Act, 1996 can only be made within three months which is extendable by a maximum period of thirty days for sufficient cause. The effect of this judgment is that there is now a certainty to when a particular dispute is going to end. No arbitral award can now be challenged after such period of 120 days.

---

[10] SCG Contracts India Pvt. Ltd. v. K.S. Chamankar Infrastructure, (2019) SCC Online SC 226.

[11] Simplex Infrastructure Ltd. v. Union of India, (2019) 2 SCC 455.

3. Jignesh Shah v. Union of India

In *Jignesh Shah v. Union of India*,[12] the Supreme Court held that an insolvency petition would be time barred if the winding up petition that formed the basis of it is itself time barred even if a civil suit for recovery in relation to the same debt was already pending. Similar to *Simplex Infrastructure* (supra), this judgment also brings about certainty in as much as dead claims can no longer be used for thwarting business vide the insolvency route. Strict timelines would ensure discipline in the number and kind of cases that come before the Court.

There are multiple other such judgments passed by the Supreme Court in the last 1 year which emphasise on the need to stick to timelines and/or ensuring a consistent legal regime for businesses. However, for the purposes of this article, we shall focus on two such recent cases where the Supreme Court can be said to have ventured into territories which are generally considered to be out of bounds for courts. These judgments stand out due to the bold and affirmative stand taken by the Supreme Court against the executive as well as the legislature.

4. Hindustan Construction Company Limited v. Union of India

First of the two cases is the recent case of *Hindustan Construction Company Limited v. Union of India,*[13] (hereinafter '**HCC case**') where the Hon'ble Supreme Court pushed certain judicial boundaries to ensure a

[12] Jignesh Shah v. Union of India, (2019) 10 SCC 750.
[13] Hindustan Construction Company Limited v. Union of India, 2019 SCC OnLine SC 1520 [hereinafter **HCC Case**].

significant victory for arbitration in India. The interesting part about this case starts much before the time when this case was even filed. This is a unique case in as much as a certain Supreme Court Judge literally invited a constitutional challenge against Section 87 of the Arbitration Act in open court. Subsequently, in the said case, the Hon'ble Court through the Hon'ble Judge, struck down Section 87 of the Arbitration and Conciliation Act, 1996 as amended in 2019. Section 87 as inserted vide Section 13 of the Arbitration and Conciliation (Amendment) Act, 2019 reads as:[14]

> 87. Unless the parties otherwise agree, the amendments made to this Act by the Arbitration and Conciliation (Amendment) Act, 2015 shall-
>
> (a) not apply to-
>
> (i) arbitral proceedings commenced before the commencement of the Arbitration and Conciliation (Amendment) Act, 2015;
>
> (ii) court proceedings arising out of or in relation to such arbitral proceedings irrespective of whether such court proceedings are commenced prior to or after the commencement of the Arbitration and Conciliation (Amendment) Act, 2015;
>
> (b) apply only to arbitral proceedings commenced on or after the commencement of the Arbitration and Conciliation (Amendment) Act, 2015 and to court proceedings arising out of or in relation to such arbitral proceedings.

[14] Arbitration and Conciliation Act, 1996, No. 26, Acts of Parliament, 1996 (India), § 87 (amended in 2019).

On a bare reading of Section 87, it prima facie appears that the objective of its insertion was to nullify the effect of a previous judgment of the Hon'ble Supreme Court in the *BCCI case*.[15] Notably, in the BCCI case, the Court had specifically warned against the enactment of Section 87 that was being planned to be done in accordance with the report of Justice Srikrishna Committee, as the same would be contrary to the object of the 2015 Amendment Act. Section 87 provided that the amendments made in 2015 will not apply to court proceedings arising out of, or in relation to, arbitration proceedings that were initiated prior to the enactment of the 2015 Amendment irrespective of the date of commencement of the court proceedings. It also clarified that the amendments introduced in 2015 would apply only to those arbitral proceedings which commenced on or after the commencement of the 2015 Amendment Act and to court proceedings arising out of or in relation to such arbitration proceedings.

Taking a business friendly approach, in order to maintain a stable and consistent arbitration regime, the Hon'ble Court struck down Section 87 as inserted vide the 2019 amendment. In its judgment, the Court observed that the mischief of the misconstruction of Section 36 was rectified by the amendments introduced 19 years after the original enactment. The Court found the 2019 amendments to be manifestly arbitrary since they attempted to undo the aforesaid rectifications introduced via amendments made in 2015. The Court held the revival of

[15] B.C.C.I. v. Kochi Cricket Pvt. Ltd., (2018) 6 SCC 287.

grant of automatic stay to be in contravention of the object of Arbitration and Conciliation Act, 1996, and the subsequent amendment introduced in 2015.

The Court also noted that certain applications seeking refund of deposits had been filed before it seeking release of the payment already made subsequent to the conditional stay order that had been passed. The Court specifically highlighted the issues that would arise as a result of such turning of the clock backwards, and held:

> After the advent of the Insolvency Code on 01.12.2016, the consequence of applying Section 87 is that due to the automatic-stay doctrine laid down by judgments of this Court - which have only been reversed today by the present judgment - the award-holder may become insolvent by defaulting on its payment to its suppliers, when such payments would be forthcoming from arbitral awards in cases where there is no stay, or even in cases where conditional stays are granted. Also, an arbitral award-holder is deprived of the fruits of its award - which is usually obtained after several years of litigating - as a result of the automatic-stay, whereas it would be faced with immediate payment to its operational creditors, which payments may not be forthcoming due to monies not being released on account of automatic-stays of arbitral awards, exposing such award-holders to the rigors of the Insolvency Code. For all these reasons, the deletion of Section 26 of the 2015 Amendment Act, together with the insertion of Section 87 into the Arbitration Act, 1996 by the 2019 Amendment Act, is struck down as being manifestly arbitrary under Article 14 of the Constitution of India.

In order to understand the underlying issue here, it is important to know about the decisions of the Hon'ble Supreme Court in *NALCO v. Pressteel & Fabrications Pvt. Ltd.,*[16] and *Fiza Developers & Inter-Trade Pvt. Ltd. v. Amci (I) Pvt. Ltd.,*[17] which form a part of the background. Subsequent to these two decisions, the Court had observed that automatic suspension of the execution of the award defeats the objective of the Arbitration Act. The Hon'ble Supreme Court accordingly recommended amendment to the section, subsequent to which, Section 36 was amended in 2015 for preventing automatic stay of arbitral awards. During the hearing of the *BCCI case*, the Court's attention was drawn to press releases concerning the enactment of Section 87 in the Arbitration Act. In its judgment in the *BCCI case*, the Hon'ble Supreme Court interpreted Section 36 amended in 2015 in consonance with the object of the Act. It also advised the Government against the enactment of Section 87 that had been proposed vide Press release dated 07.02.2018. However, the government went ahead with the 2019 Amendment Act which came into force with effect from 30.08.2019 and included Section 87.

The prompt response of the Hon'ble Court boosted investor sentiments as the decision is a progressive step towards building investor confidence and providing a consistent legal regime which gives tremendous hope to India Inc. However, what is interesting to note is that this judgment is effectively a classic case of judicial overreach by the Apex Court. The Supreme Court tried to expand its boundaries at the cost

[16] NALCO v. Pressteel & Fabrications Pvt. Ltd., (2004) 1 SCC 540.
[17] Fiza Developers & Inter-Trade Pvt. Ltd. v. Amci (I) Pvt. Ltd., (2009) 17 SCC 796.

of not maintaining the sanctity of separation of powers. After having opined in open court that the Government is unnecessarily tinkering with the arbitration regime in India by introducing the 2019 amendment, and more or less assuring that they will strike it off if it comes before the Court, critics can fairly argue predisposition on part of the Judge while deciding the said case. While certain questions may arise, the fact that Court asserted its freedom from the executive as well as the legislature is remarkable, especially when the act of the Court promotes a favourable investor regime which has a consistent legal policy over a course of time. It gives an assurance that the parliament will not be able to make changes on mere whims.

5. Dharani Sugars and Chemicals Ltd. v. Union of India

Not so long before the HCC Case, the Apex Court in a similar move had struck down, in entirety, a circular issued by India's top banking regulator, the Reserve Bank of India (hereinafter '**RBI**'), which directed banks to initiate insolvency proceedings against certain non-performing assets (hereinafter '**NPAs**'). The Preamble of the Reserve Bank of India Act, 1934 (hereinafter '**the RBI Act**') shows that RBI has been constituted to operate the currency and credit system of the country to its advantage. In the *RBI Circular case,*[18] turning a blind eye towards the health of banking system as well as intention of the parliament, the Hon'ble Supreme Court made RBI a toothless monster as far as its powers in respect of directing banks to initiate insolvency proceedings is concerned.

[18] Dharani Sugars & Chemicals Ltd. v. Union of India, (2019) 5 SCC 480 [hereinafter **RBI Circular Case**].

Health of a country's banking system is extremely important for its macro economy. Non-performing assets are a critical bottleneck for a developing economy as unresolved non-performing assets clog a good amount of capital which can be used for boosting the economy. When a borrower's account becomes stressed and is classified as a non performing asset, banks have to make provision for their losses which further depletes the banks' capital. Since banks are subject to regulatory action once they lose capital, they tend to evergreen their non-performing assets and thus misallocate further credit to unhealthy and unworthy borrowers. Once a significant part of the banking system is affected with the problem of high stressed assets, impact on the investment climate becomes very adverse, especially on smaller businesses which are primarily dependent on banks for funding.[19]

Due to the absence of an effective and time sensitive mechanism for the resolution of stressed assets for the purpose of protecting the interest of creditors, Indian banks were avoiding recognition of stress in non-performing large assets accounts. The same explains as to why India has one of the largest number of cases in relation to failed restructuring. Banks, instead of resolving the stress feel incentivized to avoid a downgrade and delay the required provisioning for losses. This is why we have a history of a large number of NPA accounts being ever greened, without any resolution. Notably, RBI had created a number of out of court resolution mechanisms through statutory circulars such as those providing

[19] *Id.* (Written Submissions tendered by RBI in the RBI Circular case).

for Joint Lenders Forum (JLF), Strategic Debt Restructuring (SDR) (created together with the Securities and Exchange Board of India), and scheme for Sustainable Structuring of Stressed Assets (S4A) etc. for large stressed accounts, and none of them had turned out to be successful.

Reserve Bank of India issued circular dated 12.02.2018 which aligned RBI's guidelines for resolution of stressed assets at the pre-Insolvency and Bankruptcy Code, 2016 (hereinafter '**IBC**') stage with the IBC in the context of the aforesaid mechanisms failing to resolve the stress. Since, there was no comprehensive statutory law to effectively deal with insolvency proceedings, RBI issued circular dated 12.02.2018 for dealing with stressed accounts, especially for large value credits. The said circular directed banks to initiate corporate insolvency resolution process (hereinafter '**CIRP**') against those companies which: (1) had an aggregate exposure of more than Rs. 2000 crore, and (2) where no resolution plan had been implemented in respect of them within 180 days of default. The purpose of the circular was to widen the powers of banks in resolving stress in their assets by removing limitations and restrictions contained in the extant instructions/circulars that were also introduced for the purpose of resolving stress.

However, disregarding the contentions put forward by the regulator during the arguments, Hon'ble Court held the impugned circular dated 12.02.2018 to be ultra vires Section 35-AA of the Banking Regulation Act, 1950 (hereinafter '**the Banking Regulation Act**') In the judgment, despite holding that RBI has a specific power to direct banks to

move under the Insolvency Code against debtors, and such exercise of powers by RBI was not outside the scope of laws governing it (RBI Act and the Banking Regulation Act). The Court also specifically observed that Sections 21 and 35-A of the Banking Regulation Act conferred very wide powers on RBI to give directions when it came to matters specified therein. However, the Hon'ble Court ultimately went on a very interesting route holding that even though prior to the enactment of Section 35-AA, RBI could have issued directions u/ss. 21 and 35-A to a banking company to initiate CIRP, but after enactment of Section 35-AA, RBI can give such directions only under the purview of Section 35-AA.

The Court based its reasoning on the principle that in case a statute confers power to do a particular act in a particular way, then such power has to mandatorily be exercised in the prescribed way and, exercise of such power in any other way is prohibited. The Court went on to hold:

> It is clear that RBI can only direct banking institutions to move under the Insolvency Code if two conditions precedent are specified, namely, (i) that there is a Central Government authorisation to do so; and (ii) that it should be in respect of specific defaults. The Section, therefore, by necessary implication, prohibits this power from being exercised in any manner other than the manner set out in Section 35-AA.
>
> …Stressed assets can be resolved either through the Insolvency Code or otherwise. When resolution through the Code is to be effected, the specific power granted by Section 35-AA can alone be availed by RBI. When resolution dehors the Code is to be effected, the general powers under Sections 35-A and 35-AB are to

> be used. Any other interpretation would make Section 35-AA otiose. In fact, Shri Dwivedi's argument that RBI can issue directions to a banking company in respect of initiating insolvency resolution process under the Insolvency Code under Sections 21, 35-A and 35-AB of the Banking Regulation Act, would obviate the necessity of a Central Government authorisation to do so. Absent the Central Government authorisation under Section 35-AA, it is clear that RBI would have no such power.

The Court, despite acknowledging the wide gamut of powers available in the hands of RBI, decided to take a conservative approach to the issue. While this judgment did provide relief to a lot of promoters, the same came at the expense of the banking system of India. The Court instead of appreciating the context in which the impugned circular was issued, decided to rely on certain hyper technicalities to hold that RBI does not have the requisite power to issue such circular. The Court failed to give any consideration to the fact that at the time of enactment of Section 35-A, express clarification was given by the legislature to the extent that Section 35-A is mere clarificatory in nature, and RBI had the powers to direct banks to initiate insolvency under other provisions.

II. DICHOTOMY IN APPROACH

Of late, Indian Supreme Court has been trying to increase its jurisdiction by unnecessarily taking up policy related issues which are supposed to be outside its domain. Though it is outside the scope of this article, it is important to note that the current attitude of Supreme Court liberally expanding its jurisdiction raises a number of interesting

constitutional issues, The nature of approach taken by Supreme Court in the aforesaid two decisions (*HCC case* and *Dharani Sugars case*) are in stark contrast with each another. While the Court decided to take on an activist role in the HCC case, Court stuck to a conservative line of thought while deciding the RBI Circular case. What is common in both the judgments however, is the outcome – both the judgments foster an investor friendly climate.

The HCC case gave a huge relief to investors by ensuring that an arbitral award does not automatically get stuck in the judicial logjam that is suffering from massive backlog. It also assured India Inc. that if the government ever falters with its duty of providing a stable and consistent legal regime, the Courts would step in to make the required course correction.

The dictum in RBI Circular case has significantly reduced the pressure on banks and promoters to comply with the rigid timelines that were set out in the circular that was held to be ultra vires. It also allowed banks and promoters to fall back upon the previous resolution mechanisms which provided for a much more relaxed timeline albeit at the cost of concerned parties adopting a lax attitude towards reaching a resolution.

Interestingly, RBI has come up with a novel approach to circumvent the Supreme Court dictum by forcing the banks to make additional provisions as an alternative to not initiating CIRP proceedings. This has forced the concerned banks to initiate insolvency proceedings as they get relief from the provisioning requirements easily upon initiating

CIRP proceedings. While half of the additional provisions that are made by the bank can be reversed upon initiating CIRP proceedings, the remaining additional provisions can be reversed at the time of admission of CIRP. Initiation of CIRP is much simpler than finalising and implementing a resolution plan under any of the other schemes and/or being able to complete the proceedings in relation to assignment of debt/recovery– the other two ways of reversing the additional provisioning which are significantly more time consuming and difficult than initiating CIRP.

III. CONCLUSION

As noted in the Indian Economic Survey 2018-19,[20] delays in the enforcement of contracts and dispute resolution are the single biggest hurdle to India achieving a higher Gross Domestic Product (GDP) growth. It is notable that the Indian judiciary at all levels has been stepping up to the challenges despite numerous hurdles. From civil courts operating out of tin sheds to increased emphasis on alternate modes of dispute resolution by the Apex Court, every court in India is contributing towards making India's legal regime an investor friendly regime. There exist multiple reports and surveys which indicate that despite the multiple and attractive opportunities for investment available in India, the fear of getting stuck in litigation that moves at the pace of a corpulent snail with a severe case of gout, is the biggest apprehension of foreign investors who seek/look

[20] Ministry of Finance, *Economic Survey 2018-19*, GOVERNMENT OF INDIA, https://www.indiabudget.gov.in/budget2019-20/economicsurvey/doc/echapter.pdf. (Chapter 5, Volume I).

forward to invest in India.[21]

There are multiple solutions which involve participation and support from various stakeholders in India. A number of countries such as USA have successfully tackled similar issues which arise out of legal formalism. Promoting Alternative Dispute Resolution (ADR), and incentivising the adoption of mediation in civil and family disputes for arriving at a settlement outside the Court can be effective in reducing the judicial pendency. Fine tuning the existing system with the help of modern techniques developed over the course of last few decades would help in making justice more accessible to the Indian masses. While mandating ADR through legislation is one solution, jurists have highlighted the pitfalls of increased regulation of alternate modes of dispute resolution.

As stated in the Economic Survey of 2018-19, a major hurdle to India's economic growth and social well-being can be easily stabilised by means of a relatively small investment in the legal system. The much-debated judicial logjam is after all solvable. It is however recommended that in the quest for solving a problem, stakeholders in India must not lose track of the most important aspect of the end goal – delivering justice. Justice must be done not only to those who seek relief, but also to those who are indirectly affected. We need to engineer dispute resolution

---

[21] Ministry of Finance, *Economic Survey 2018-19*, GOVERNMENT OF INDIA, https://www.indiabudget.gov.in/budget2019-20/economicsurvey/doc/echapter.pdf; Amitabh Kant, *How to speed up judiciary: Let's make India's slow courts world class*, ECONOMIC TIMES (16.05.2017), https://economictimes.indiatimes.com/news/politics-and-nation/how-to-speed-up-judiciary-lets-make-indias-slow-courts-world-class/.

processes that would promote, instead of impeding social welfare and access to justice.